OVERVIEW

We have adopted a prudent risk management strategy, seeking to balance risk and returns with sustainable growth and sound asset quality to achieve an appropriate level of risk-adjusted returns and capital adequacy.

The objectives of our risk management are:

- continuously enhancing our corporate governance and risk management to ensure that our Board of Directors and senior management as well as our risk management personnel throughout our organizational structure follow our risk management strategies and implement comprehensive risk management;
- establishing a comprehensive, independent and vertically-integrated risk management organizational framework and developing a risk management organizational structure with clearly-defined division of responsibilities;
- implementing robust risk policies and procedures to ensure that our risk management function covers all of our business lines, products and personnel;
- developing and applying advanced risk management tools and methodologies to accurately identify and measure risks and to ensure the prompt communication of information throughout various levels of our organizational structure; and
- cultivating a sound risk management culture through continuous management reinforcement, rigorous implementation of risk management polices and management accountability, and bank-wide in-depth employee training.

RISK MANAGEMENT INITIATIVES IN RECENT YEARS

Prior to 1996, we were a state-owned specialized bank and our risk management capabilities were limited. In the middle to late 1990s, we began to operate on a commercial basis and started to manage our risks more proactively.

In 2000, based on our existing credit extension authorization procedures, we upgraded and standardized our pre-loan review, credit approval and post-disbursement management policies and procedures and established designated credit approval committees. In 2002, we adopted the Credit Management System (CMS) as the primary platform for our credit businesses. In 2005, we adopted economic capital management tools to manage our overall risk profile through measuring, allocating and controlling the risk exposures along our various business lines and in terms of industries and regions. We also adopted risk management indicators to evaluate the performance of our branches and employees.

In 2007, we established the Risk Management Department at our head office and began to implement our centralized risk management strategy. In 2009, we established a comprehensive risk management organizational structure. Under the principle of separating the supervision function from the formulation and implementation of risk management policies, we have defined risk management responsibilities and related reporting lines of our Board of Directors and its specialized committees, senior management and the specialized committees under their supervision, as well as our various departments with risk management responsibilities.

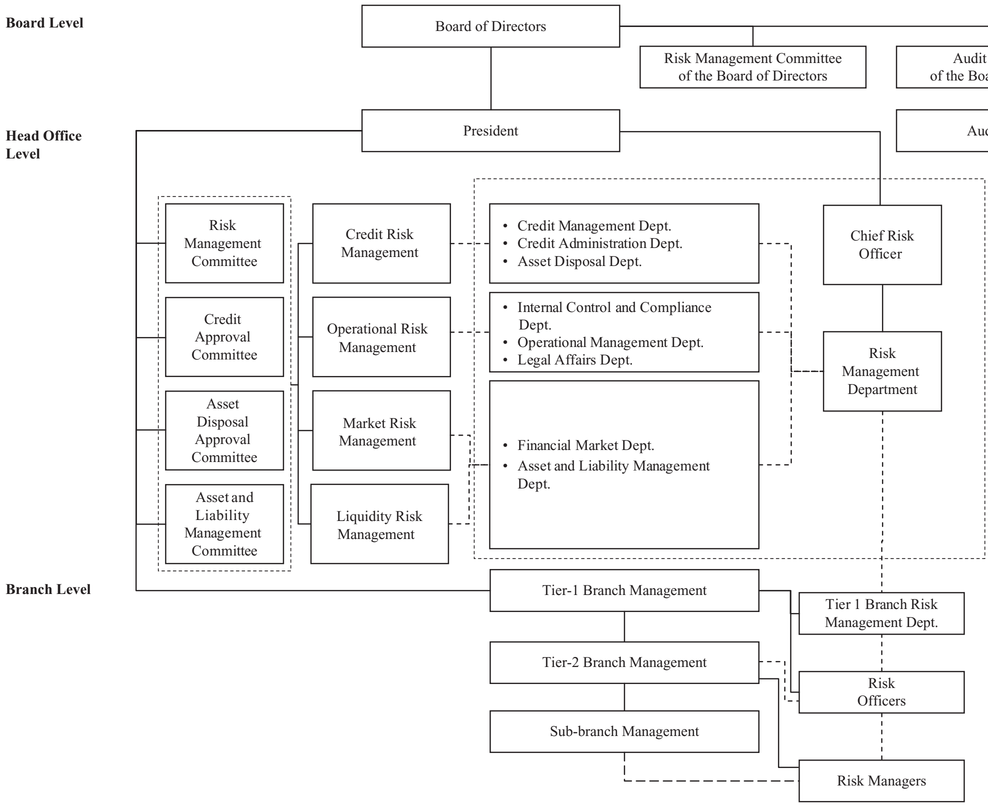
Since 2007, we have undertaken a number of significant measures to improve our credit management infrastructure. We have established a credit policy framework consisting of policy guidelines, industry-specific and region-specific credit guidelines and customer list-based management system to implement differentiated credit management. We have improved our credit review and approval system and created the position of independent credit approval officers, moving toward centralized credit review and approval and online operations. Furthermore, we have developed an agenda for implementing Basel II, built up our internal rating infrastructure and initiated the development of internal models for market risk management and advanced measurement approaches for operational risk management.

In 2009, we developed and began to implement an agenda for building up a comprehensive risk management system. We have strengthened the independence and accountability of our risk management departments and appointed risk officers and risk managers at our tier-2 branches and sub-branches, respectively. We have further refined our risk management tools and systems by upgrading our Credit Management System (CMS), implementing a 12-category loan classification system for corporate loans, introducing a series of risk exposure limits and increasingly applying quantitative methodologies to risk management. We have also improved our economic capital management based on our internal historical data and expanded the coverage of our economic capital management from credit risk management to market and operational risk management and from our domestic branches to our overseas branches.

We believe the implementation of the foregoing risk management strategy and initiatives has led to an enhanced operating framework, improved risk management capabilities and a rigorous risk management culture.

RISK MANAGEMENT STRUCTURE

The chart below illustrates our risk management structure:



Board of Directors and Board Committees

Our Board of Directors bears the ultimate responsibility for risk management. It performs risk management functions through the Risk Management Committee and the Audit Committee under the Board of Directors.

The Risk Management Committee of the Board of Directors is primarily responsible for reviewing our risk management strategies, policies and procedures, assessing our risk management and internal control efforts, evaluating the organizational framework, operating procedures and effectiveness of our risk management and internal control departments and making recommendations to our Board of Directors accordingly.

The Audit Committee of the Board of Directors is primarily responsible for monitoring our internal control function, reviewing and overseeing the implementation of our critical accounting policies, overseeing and evaluating our internal audit operations and external auditors, reviewing annual audit reports and annual financial statements and making recommendations to our Board of Directors accordingly.

For the details of the respective responsibilities of our Board of Directors as well as the Risk Management Committee and the Audit Committee under the Board of Directors, see "Appendix VIII—Summary of Articles of Association" and "Directors, Supervisors and Senior management—Board of Directors Committees."

Senior Management and Special Committees

Our senior management assumes the highest level of execution power in risk management.

President

Our president manages risks associated with our business operations, formulates risk management policies and procedures, determines economic capital allocation and makes recommendations and reports our overall risk management operations to our Board of Directors. Our president is also responsible for the implementation of risk management strategies, plans, policies and systems as determined by our Board of Directors.

Special Committees under Senior Management

We have four special committees under our senior management, namely, the Risk Management Committee, the Credit Approval Committee, the Asset Disposal Approval Committee and the Asset and Liability Management Committee, which are responsible for organizing, coordinating and reviewing various risk management tasks.

- *Risk Management Committee*. The Risk Management Committee has three specialized sub-committees, namely, the Credit Risk Management Committee, the Market Risk Management Committee and the Operational Risk Management Committee. The Risk Management Committee is responsible for analyzing and assessing our bank-wide risk profile, reviewing and formulating our bank-wide risk management plans and risk exposure limits, determining and adjusting our risk management measures, reviewing, coordinating and supervising the implementation of policies, procedures and methodologies relating to credit, market and operational risk management as well as significant risk management initiatives, and leading our bank-wide risk management efforts.
- *Credit Approval Committee.* The Credit Approval Committee is responsible for reviewing the credit applications exceeding certain amount and of high levels of complexity. It also reviews special authorizations and special credit extensions as well as certain other credit risk management operations. It also oversees customer credit rating.
- *Asset Disposal Approval Committee.* The Asset Disposal Approval Committee reviews the disposal of our non-performing loans and other impaired assets exceeding certain amounts as well as write-offs, loan restructuring, waivers of interest and foreclosure on repossessed assets.
- *Asset and Liability Management Committee.* The Asset and Liability Management Committee is responsible for formulating our strategies for balance sheet management and capital management. It reviews our medium- to long-term business plans and annual business plans and conducts periodic examinations of our business operations. It is also a decision-making body in our liquidity risk management.

Chief Risk Officer

The primary responsibility of our chief risk officer is to assist our president in risk management. Currently, our chief risk officer is Mr. SONG Xianping.

Head Office Risk Management Departments

Risk Management Department

The Risk Management Department coordinates our bank-wide risk management efforts and carries out risk management responsibilities, including the formulation and implementation of our risk management strategies, policies and procedures, the coordination on our implementation of Basel II and the development of risk measurement tools meeting the applicable regulatory requirements. The Risk Management Department is also responsible for conducting customer credit ratings, supervising asset classification, assessing our assets for impairment, measuring our bank-wide economic capital, monitoring key risk indicators and issues and organizing risk reporting. It also coordinates the determination of risk exposure limits, formulates risk portfolio management plans and assesses our risk exposure levels. In addition, it coordinates risk management functions across all branches and business lines.

Credit Management Department

The Credit Management Department is responsible for establishing and strengthening our credit risk management system. It develops industry-specific credit guidelines, determines customer admission criteria and organizes and implements customer list-based management. It reviews and approves credit extensions in accordance with our policies and procedures, and evaluates counterparty risks. It is also responsible for refining our credit management system to improve our credit risk identification, measurement and mitigation capabilities.

Credit Administration Department

The Credit Administration Department is primarily responsible for risk management in connection with loan disbursements. It coordinates and oversees disbursement of loan funds and post-disbursement management, conducts on-site inspections of significant risks identified through online supervision, and organizes compliance review of our credit review and approval personnel.

Asset Disposal Department

The Asset Disposal Department is responsible for formulating the policies and procedures in respect of disposal of non-performing assets and coordinating the implementation efforts. It also conducts on-site inspections of large-amount or cross-regional non-performing asset disposals, monitors the implementation of specific asset disposal projects, and manages books for large-amount non-performing assets. It also coordinates our asset preservation efforts and manages foreclosures and write-offs of non-performing assets.

Asset and Liability Management Department

The Asset and Liability Management Department is responsible for formulating and implementing risk management policies and procedures in respect of liquidity risk as well as interest rate risk and exchange rate risk arising from our banking book.

Financial Market Department

Pursuant to the risk preferences determined by our head office, the Financial Market Department manages market risk arising from our investment and trading portfolios both for our own account and on behalf of our customers, within the respective transaction authorizations and market risk exposure limits.

Internal Control and Compliance Department

The Internal Control and Compliance Department oversees and monitors the implementation of risk management policies and procedures, rectifies deficiencies and conducts internal control and compliance inspections and assessments. It manages compliance risks, conducts compliance evaluations and tests on our business procedures and new product and service offerings and monitors authorizations.

Operational Management Department

The Operational Management Department is responsible for managing our bank-wide back-office operational risks, formulating and implementing policies and procedures relating to operational management, establishing and refining our operational risk management system, streamlining our back office procedures for various business lines and products and deterring operational risk through centralized management.

Legal Affairs Department

The Legal Affairs Department is responsible for our bank-wide legal risk management, ensuring the legality and thoroughness of our risk policies and managing risks associated with litigation, contract disputes and intellectual property.

Branch Level and Sub-branch Level Risk Management Structure

Branch and Sub-branch Management

The heads of our branches or sub-branches are the primary responsible persons for our risk management operations at their respective branches or sub-branches. The deputy heads in charge of risk management organize and coordinate risk management operations. Meanwhile, risk management at our tier-2 branches and sub-branches is also supervised by risk officers and risk managers, respectively, appointed by the higher-tier branches. As a further check and balance, the regional offices of our Audit Office conduct periodic review of branch-level risk exposures.

Risk Management Committees and Risk Management Departments at Branch and Sub-branch Levels

We have established risk management committees at our tier-1 and tier-2 branches under their respective management. The branch-level risk management committees are responsible for reviewing the risk exposure limits and risk portfolios within their respective jurisdictions, reviewing and organizing the implementation of risk management objectives and procedures, and reviewing risk management issues within their authorization. The branch-level risk management committees conduct periodic analysis and review of the overall risk exposure and supervise risk management functions.

At our tier-1 branches, we have established risk management departments that are responsible for setting forth comprehensive risk management measures and supervising the implementation of various risk management strategies and policies. The departments also supervise asset classification and impairment tests, formulate and supervise the implementation of risk exposure limits and portfolio management plans. In addition, they manage and organize trainings to the risk managers within their respective jurisdictions and evaluate their performance. These risk management departments also examine, analyze and evaluate the risk management functions of the relevant departments and lower-tier branches.

The credit management departments at our tier-2 branches or the senior management at our sub-branches perform risk management functions.

Risk Officers and Risk Managers

As part of our risk management initiatives targeting at strengthening risk management at our lower-tier branches and sub-branches, we have started a pilot program to appoint risk officers from tier-1 branches to tier-2 branches as well as risk managers from tier-2 branches to sub-branches. The risk officers and risk managers supervise and assess risk management functions at the branches or sub-branches where they are stationed. They report to the management team of the branches that appointed them.

CREDIT RISK MANAGEMENT

Credit risk is the risk of loss from the default by an obligor or counterparty when payments fall due. We are exposed to credit risk primarily through our loan portfolio, investment portfolio, guarantees and various other on- and off-balance sheet credit risk exposures.

We manage credit risk through a variety of methods, including streamlining our credit approval process, establishing bank-wide standardized authorization and credit extension management system, monitoring risk exposure and borrower concentrations and mitigating credit risk through the use of collateral and other arrangements.

We have increased efforts to prepare for the implementation of Basel II and our adoption of industry-specific credit guidelines and customer list-based management to improve credit risk management capabilities and refine our credit asset profiles. To further strengthen our overall credit risk management capabilities, we have upgraded our existing CMS and developed a credit risk reporting system.

Credit Risk Management for Corporate Loans

Credit Guidelines

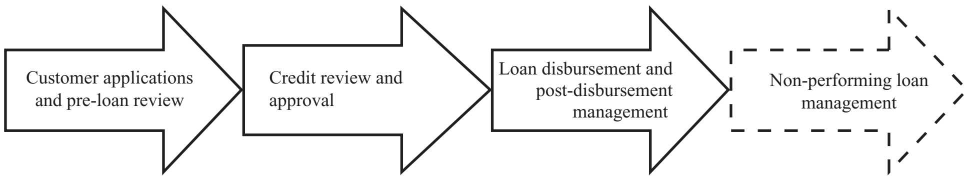
We are focused on the development and implementation of our credit guidelines and are seeking to achieve a balance between loan growth and a prudent risk management culture. We formulate credit guidelines on an annual basis to streamline our credit business procedures, adjust our loan portfolio compositions and prioritize our lending to the key regions, industries and customers.

Our industry-specific credit guidelines consist primarily of industry-specific customer admission policies, authorization policies and post-disbursement management requirements. We adjust our credit guidelines based on a number of considerations such as changes in the PRC government's industry policies and the developments of various industries as well as the overall effectiveness of our existing credit guidelines. We have developed industry-specific credit guidelines for 13 industries, including, among others, real estate, iron and steel, coal and textiles. We have also started to implement a customer list-based credit management system for customers in nine industries, including, for example, iron and steel as well as cement industries, and divided our loan customers into "support," "maintenance," "reduction" and "termination" categories. We periodically impose credit exposure limits and release recommended credit limits in respect of industries with relatively large exposure and higher risk to adjust and control the total credit exposure to specific industries and refine the mix of our loan portfolio based on industry prospects, the overall credit quality of individual industries and regulatory changes.

We also proactively adjust our credit guidelines in line with the PRC government's macroeconomic control policies. For example, in 2009 and 2010, the PRC government implemented certain restrictive measures with respect to the real estate and steel industries. Also see "Risk Factors—Risks Relating to Our Loan Portfolio—If we are unable to effectively maintain the quality of our loan portfolio, our financial condition and results of operations may be materially and adversely affected." In light of these measures, we have adjusted our credit guidelines with a more prudent view to extending credit to borrowers in the real estate industry and the steel industry and set target limits on the growth in our loans to these industries in 2010. We have further clarified our customer admission criteria and prioritized our lending to key cities and high quality customers. With respect to borrowers in the steel industry, we have tightened credit approval authorizations and limited new credit extensions to our valued customers.

In lending to government financing vehicles, we apply the same review, approval and monitoring criteria to these loans as we do to loans to other corporate customers. We have clearly defined the admission standards for loans to government financing vehicles, and we seek to focus on government-sponsored projects with sufficient cash flows and secured sources for loan repayments as well as the projects sponsored by the governments of provincial, provincial capital-levels and above. Our tier-1 branches implement customer list-based management of government-sponsored projects within their respective jurisdictions and determine admission criteria for non-commercial projects sponsored by local governments of city level or lower. For these projects, we require that equity investments in these projects be in place prior to our loan disbursements, or simultaneously with our loan disbursements on a proportional basis. Loans to financing vehicles for local governments below the city level must be fully secured by land or building.

The following flow chart illustrates the basic process for our credit business.



Customer Applications and Pre-Loan Review

We conduct pre-loan review under a policy of two-person investigation and review. Pre-loan review is carried out by a primary reviewer (generally, a customer manager) and an assistant reviewer (for example, a business manager) at a branch or sub-branch. For large loans to a single borrower and loans for medium- and long-term projects, reviewers from the corporate banking business departments at higher-tier branches conduct independent customer reviews. To avoid conflicts of interest, we require a reviewer to refrain from participating in any credit review relating to a company controlled by the reviewer or the reviewer's close relatives. We conduct pre-loan review and customer information verification through both on-site visits and circumstantial investigations. When necessary, we use a third-party credit agency to verify customer information.

We conduct pre-loan review to: (i) collect basic information such as the compliance track record, shareholders and managers, industry, growth prospects and business of the applicant; (ii) analyze the use of the loan proceeds and sources for repayment; (iii) study the applicant's financial statements, cash flows and request additional information (such as evidence of tax payments and utilities bills) from the applicant if we believe that the financial data collected do not fully reflect the applicant's financial condition; (iv) assess the creditworthiness of the applicant and its management, its loan repayment history and its ability to fulfill contractual obligations; (v) review the collateral provided by the applicant and guarantees provided by the guarantor; and (vi) examine the loan application pursuant to our credit policies. Upon the completion of the pre-loan review, the reviewers prepare a written report, which serves as one of the main bases for our credit decision. The primary reviewer and the assistant reviewer are jointly accountable for the conclusion of their pre-loan review.

Customer Credit Rating

We maintain a ten-grade rating system, namely, AAA+, AAA, AA+, AA, A+, A, B, C, D and Rating Exempted, and assign a credit rating to a customer based on its scale of operation, competitiveness, growth prospects, quality of management, net cash flow, debt repayment ability, profitability, contribution to our business, creditworthiness and other factors.

In principle, we rate all customers that have outstanding loans with us and that have provided guarantees to secure our loans on a periodic basis, and the credit ratings assigned are generally valid for no more than one year. We assign a credit rating to a new customer before granting credit to such customer. If there is a material change affecting a customer's repayment ability or creditworthiness, we re-rate the customer. The customer credit rating results have been used in our credit approvals, loan classifications, loan loss provisioning, management of exposure limits, risk reporting and economic capital management.

Collateral Appraisal

For loans secured with collateral, we conduct collateral appraisals prior to loan approval either internally or through external appraisers. We require a final confirmation of the appraised value from an appraiser within our bank regardless whether the appraisal was performed by an external appraiser or by our own employees. Loans secured by collateral are generally subject to the following loan-to-value ratio limits, depending on the type of collateral:

Type of Collateral	Maximum Loan-to-Value Ratio
Properties	
Land use rights and buildings	70%
Manufacturing equipment	Up to 40% for manufacturing equipment for general use; up to 20% for manufacturing equipment for specialized use
Inventories	Generally up to 50%, maximum limit 70%
Monetary assets	
Government bonds and financial bonds	If in the same currency as our loans, the amount of collateral shall be no less than the loan amount; if in a different currency, up to 90%
Corporate bonds	Up to 80% for listed corporate bonds; up to 50% for other corporate bonds
Warehouse receipts	Up to 85% for exchange standard warehouse receipts; up to 70% for other warehouse receipts

We generally require regular reappraisal of collateral. In respect of a third-party guarantor, we assess the guarantor's financial condition, credit history and ability to meet its obligations to determine the appropriate guarantee amount.

Credit Review and Approval

Our credit approval function for corporate loans is performed primarily by authorized approval officers, credit review and approval centers and credit approval committees.

- *Authorized approval officers.* Authorized approval officers consist of the president and the vice president in charge of credit approval at our head office and, at the branch level, the heads and deputy heads (including assistants to branch heads) in charge of credit approval at their respective branches and independent credit approval officers who are entitled to approve credit. Independent credit approval officers are authorized to make loan approval decisions based on their independent investigation, review and evaluation. Independent credit approval officers at branch level typically consist of credit approval officers at the same branch or at the higher-tier branch depending on which branch appointed them. The independent credit approval officer appointed by the same branch reports to his own branch and receives his approval authorization from the branch head, while an independent credit approval officer appointed by the higher-tier branch reports to the higher-tier branch that appointed him and receives his authorization approval from the head of that higher-tier branch. The independent credit approval officers approve loans according to their specific areas of expertise and are organized into groups focusing on different business lines such as corporate banking, retail banking and County Area Banking Business, respectively.

- *Credit review and approval centers.* We have set up credit review and approval centers at our head office and branches. Applications for loans exceeding the authorization limits of the respective independent approval officers are submitted to the credit review and approval centers for approval.
- *Credit approval committees.* We have set up credit approval committees at our head office and branches. A credit approval committee consists of chairman of the committee, credit risk department members, expert members and independent credit approval officers. The credit approval committee at the head office reviews applications for fixed asset loans with principals above certain specified amount, credit limit approval and other tasks. It currently consists of 11 members, including four expert members, one independent credit approval officer and one vice president from our head office who acts as the chairman of the committee. Sub-branches located in counties generally have no credit approval committee. Credit approval officers designated by branches of higher-tier are primarily responsible for review and approval of credit applications made through the sub-branches.

Customer Credit Limit Approval

We determine a customer's total credit limit based on a comprehensive analysis of the customer's credit rating, net assets, cash flows, collateral offered and financing needs. Our different tiers of branches may approve credit line applications within their specific authorization limits in accordance with our customer segmentation-based management system. A customer's credit limit is generally valid for no longer than one year and is subject to annual review. Even if a credit application is within the customer's credit limit, the originating branch still must carry out the required loan review and approval procedures according to its authorization limit. Credit line applications that exceed the authorization limits of the originating branches must be submitted to a higher-tier branch with requisite authorization or, if necessary, to our head office.

The entire process of credit reporting, review and approval has been automated and is managed by the CMS. The system automatically controls the authorization levels of our approval officers. If a loan application is approved, our legal departments will review the agreements on non-standard forms and correspondences and other documents for our credit extension business.

We seek to manage credit extension to group borrowers on a consolidated basis. Our credit administration departments are responsible for reviewing, approving and allocating credits made to group customers.

Loan Disbursement and Post-disbursement Management

We disburse loans upon the completion of review of disbursement-related criteria by our credit administration departments. Our business units and credit administration departments are responsible for post-disbursement management. Our post-disbursement management includes fund account monitoring, on-site examination, monitoring of the borrower, monitoring of collateral and guarantor, risk alert and management, credit asset risk classification, record-keeping and recovery of loans.

Management of Drawdown

Before signing a credit agreement, the business department in the originating branch is responsible for ensuring the satisfaction of the conditions precedent specified in the agreement for loan disbursements and drawdowns. We have designated disbursement review personnel at our tier-1 and tier-2 branches and our credit administration departments to review the application of conditions for loan disbursement and usage and the compliance with the credit agreement, collateral arrangement and other loan disbursement procedures.

Post-disbursement Monitoring

We undertake initial and follow-on monitoring at the post-disbursement stage. We generally conduct initial monitoring within 15 days from the disbursement of project loans, the credit lines for new customers and incremental credit lines for existing customers. The frequency of our regular post-loan monitoring varies depending on whether a customer is new or existing, the importance of the customer to our business, its credit rating and the loan product. We employ a variety of methods for conducting post-disbursement monitoring, including assigning a dedicated professional for each loan; monitoring the borrower's cash flows; conducting regular on-site visits to examine collateral; generating early alerts through IT platform; proactively notifying borrowers of due dates and maturity dates; regularly visiting the borrower; and terminating loan exposure to delinquent customers.

Risk Alert

We have set up a risk alert mechanism at all tiers of our branches and sub-branches. We aim to promptly detect and mitigate risks by monitoring a customer's account information, financial reports, information of suppliers and customers, and industry and macroeconomic policies.

Customer managers and designated risk management personnel are required to report to the heads of their respective departments on a timely basis upon the receipt of a risk alert signal. The business department of the branch that manages the relevant customer account, the credit administration department and others with risk management responsibilities in turn are required to formulate risk mitigation solutions. Upon authorization from relevant branch heads, the business department involved at the branch is required to start implementing the risk mitigation measures. If the originating branch is of a higher tier than the branch that manages the customer accounts, such lower-tier branch is required to report the resolution to the credit administration department of the originating branch, which will supervise the implementation.

Loan Classification

We classify a loan according to our five-category loan classification criteria, which include a comprehensive assessment of various factors such as the borrower's repayment ability and track record, its willingness to perform repayment obligations, the profitability of the project financed by the loan and the collateral provided. For details of our five-category loan classification criteria, see "Assets and Liabilities—Assets—Asset Quality of Our Loan Portfolio—Loan Classification Criteria."

Our designated loan classification officer may adjust the classification assigned to a loan in accordance to prescribed procedures in the event that there is a mismatch between a classification assigned and the criteria for such classification. The classification of a loan must be adjusted on a timely basis if a change in its risk profile is identified. Solely for risk management purposes, we adopted a 12-category classification system, which refined the five-category loan classification system, to classify our corporate loans. Classification of such loans is conducted at least on a quarterly basis.

The following table illustrates our 12-grade loan classification system:

Normal				Special Mention			Substandard		Doubtful		Loss
Normal One	Normal Two	Normal Three	Normal Four	Special Mention One	Special Mention Two	Special Mention Three	Substandard One	Substandard Two	Doubtful One	Doubtful Two	Loss

Through this loan classification system, we determine the classification of a corporate loan on the basis of both quantitative and qualitative factors through analyzing default risk of a corporate borrower and transaction risk arising from the loan and considering the estimated impairment losses. When analyzing a borrower's default risk, we consider the credit rating of the borrower and the risk factors relating to the borrower's industry, operations, management and willingness to repay the loan. When analyzing the transaction risk relating to a loan, we consider the existence, validity, adequacy and liquidity of collateral and the length of the period by which the principal or interest is overdue. The system utilizes a quantitative scoring model, through which our loan classification personnel confirms loan classification results.

Our 12-grade loan classification system is designed to enable us to better monitor changes in our asset quality, detect potential credit risks and more effectively conduct post-disbursement management of our loan portfolio. We believe that this system has helped us strengthen our loan monitoring capabilities.

We apply a five-category classification system for loans to some of our County Area corporate customers who are classified as small businesses pursuant to the rules of the CBRC.

Termination of Customers with Potential Risks

We have established an exit management mechanism in order to optimize our portfolio of borrowers and prevent potential risks from materializing. Customers with potential risks refer to those who are currently experiencing or are expected to experience adverse changes in their business or financial condition in the near future that may affect their loan repayments. For these customers, we may demand repayment of loans ahead of their contract maturities or we may reduce their respective credit lines.

We identify customers with potential risks among those whose loans are originally classified as "normal" or "special mention." Our head office adjusts, on a timely basis, the parameters and indicators for identifying customers with potential risks, in accordance with macroeconomic condition, industry policies and our business strategies. Our branches and sub-branches develop annual customer exit plans and compile exiting customer lists.

Non-performing Loan Management

We proactively manage non-performing loans to reduce risks relating to our loan portfolio and improve our recovery on disposals. We are committed to continuously improving our ability to manage non-performing loan disposals and establishing and refining our management system for non-performing loan disposals. We have undertaken various initiatives such as customer list-based management, information technology system upgrade and performance-based compensation.

Our asset disposal departments are responsible for managing our non-performing loans. We seek to recover our non-performing loans through various means, including collection, foreclosure on collateral, legal or arbitration proceedings, third-party agent collection, waiver of interest or principal, loan restructuring and write-offs.

Credit Risk Management for Retail Loans

Pre-Loan Review

Once a retail loan application is received by the originating branch, a retail loan reviewer at that branch will conduct due diligence on the loan applicant by checking relevant databases and holding in-person meetings with the applicant. For applications involving large amounts or posing high risk, two retail loan reviewers generally conduct on-site visits. For retail loans secured by collateral, the reviewers are required to conduct appraisal of the collateral. Recommendations of the reviewers are submitted to the retail loan officers, who will review and confirm before submitting the conclusions and recommendations to the appropriate credit review approval centers.

Credit Review and Approval

Our designated teams at our credit review and approval centers review retail loan applications based on their evaluation of the completeness of the application package and the applicant's risk profile. They submit their recommendations to the appropriate personnel with approval authority for final review. Applications for large loans or loans involving higher risks are required to be reviewed and approved by a credit approval committee and also approved by an authorized credit approval officer.

Loan Disbursement and Post-disbursement Management

After a loan application is approved, the originating branch assigns designated personnel to ensure the satisfaction of the conditions precedent for loan disbursement, register and record collateral, execute loan agreements and disburse loan proceeds to the borrower.

Our post-disbursement management of retail loans is conducted by both the business departments in the originating branch and the risk management departments at our different tiers of branches through the post-disbursement management system, a sub-system of the CMS. We monitor retail loan risks through daily post-disbursement monitoring, post-disbursement inspections (site-visits), account monitoring and online monitoring. Once a risk alert signal is identified, we take immediate actions to prevent and mitigate the associated risk and control potential losses.

The CMS automatically classifies our retail loans into five categories based on the number of days by which the payment of principal or any interest is overdue as well as types of collateral provided. Our business departments and risk management departments may jointly adjust the classification in response to risk data gathered through loan monitoring.

Credit Card Risk Management

We manage credit risk arising from our credit card business through the following measures:

- setting credit limits according to the risk profiles of each credit card customer to mitigate risks at preliminary stage;

- strengthening our statistical analysis capabilities, the development of credit rating data modeling and continuing to adjust our risk management policies;
- implementing a risk alert system to detect and prevent credit card fraud; and
- optimizing our risk monitoring system to enhance our capabilities to monitor and mitigate risks on a real-time basis.

Credit Risk Management for County Area Banking Business

Risk management in our County Area Banking Business falls under our bank-wide overall risk management framework and follows our bank-wide risk management system and procedures. In addition to these standardized credit policies and procedures, we have also implemented differentiated risk management policies for our County Area Banking Business.

- We have established a Credit Management Department of County Area Banking Business at the head office level and a Risk Management Center of County Area Banking Business under the Risk Management Department. We have started to appoint risk officers from our tier-1 branches to tier-2 branches and risk managers from tier-2 branches to sub-branches. We have established a dual reporting risk management structure at our branches and sub-branches in the County Areas.
- In conducting performance evaluation, we have focused on applying economic capital indicators to our branches and sub-branches in the County Areas. We have included the risk-adjusted returns as one of the key indicators to assess the performance of these branches or sub-branches.
- To balance risk and return, we are in the process of implementing a multi-channel risk mitigation mechanism where appropriate loan pricing is adopted to cover potential risk exposure. For example, we cooperate with credit guaranty companies in the County Areas to share risk exposure; in addition, we have rolled out certain products, such as forest-ownership-pledged loans, to tackle the inadequacy of collateral securing loans in the County Areas.
- We have focused on risk disciplines and set maximum non-performing loan ratios and minimum recovery ratios for loans beyond their maturities. If a sub-branch exceeds the pre-set risk control targets or there have occurred significant risk events, we may impose deadlines for remediation actions, investigate and hold the responsible parties accountable and suspend authorizations.
- In balancing risk and efficiency, we have established credit review and approval centers to strengthen our credit risk management in the County Areas. In addition, we have introduced an online information platform to speed up communications with remote areas and leverage local information sources to achieve efficiency in our risk management.
- The County Area Banking Business has been a focus of our internal review and audits. We have strengthened our internal review and audits in respect of the identity of the borrowers of our small-amount rural household loans and the performance of the departing senior management of our sub-branches in the County Areas through both on-site and off-site review and audits.

Credit Origination and Review

Based on our bank-wide risk management strategy and risk preferences and taking into consideration of the characteristics of our County Area Banking Business, we focus on the following measures. In customer identification, we focus on leading agriculture industrialization enterprises and other quality corporate customers as well as mid- to high-end retail customers. In product offerings, we focus on rural infrastructure project loans, urbanization loans, loans for County Area merchandise distributions and County Areas SME loans. In addition, we leverage our Huinong Cards to grow our small-amount rural household loans. Geographically, we focus on business development in the areas where the local economy is relatively more developed, such as the top ten counties of each province.

We have developed a score card system and designed rating indicators tailored for our County Area customer base, which consists mostly of small enterprises, private businesses and rural households. We have largely completed the development of our County Area customer rating system and expect to achieve automatic rating to further improve the accuracy of our rating system.

Credit Approval

We have established review and approval policies specifically designed for our County Area Banking Business. Higher-tier branches appoint independent credit approval officers, who are familiar with the County Area Banking Business and designated to review and approve loan applications submitted by our branch outlets in the County Areas. We have established credit review and approval centers at our tier-2 branches to ensure a centralized and efficient review and approval process. We have further improved our review and approval procedures and promoted online review and approval, to improve overall efficiency of our review and approval procedures without compromising our risk control.

We have structured multiple types of security interest such as joint household guarantees, “company + farmer” guarantees and guarantees by farmers’ cooperatives. Moreover, we have further strengthened our cooperation with insurance companies to combine loan origination with the offering of insurance products that are designed to reduce our risk exposure.

We strive to streamline our procedures for processing credit applications in our County Area Banking Business and reduce associated cost, without compromising our risk management. For example, for small business customers in the County Areas, we consolidate credit rating, approval and drawdowns into one step.

Loan Classification and Monitoring

Our bank-wide policies and procedures for loan classification apply to our County Area Banking Business. We are developing an automated loan classification system for retail loans, supplemented by manual checks. Considering such factors as the impact of natural disaster on our County Area customers’ repayment ability, we have sought to refine our loan classification criteria for loans to rural households and agriculture-related businesses and adopted more stringent loan classification criteria strictly based on the number of days by which the payment of interest or principal of a loan is overdue.

We have established an online monitoring and risk alert system for our County Area loans to monitor the risk profile of our County Area loan businesses and identify non-compliance with our policies and procedures, issue alerts, and take precautionary and corrective measures on a timely basis.

Post-disbursement Management

We conduct post-disbursement reviews and management of delinquent customers in the County Areas in substantially the same manner as we do for our Urban Area customers. We conduct post-disbursement monitoring and tracking of loans of our County Area Banking Business through CMS, with a focus on the borrower's business fundamentals and financial condition, especially cash flows. We also track non-financial information such as tax receipts and utilities bills to better understand the real business operations and fundamentals of the borrowers. We review rural household loans through, for example, spot checking Huinong Card transaction records.

Credit Risk Management for Treasury Operations

Our treasury operations involve investments in treasury bonds, government bonds, financial institution bonds, corporate bonds, commercial paper, medium-term notes, and asset-backed securities. We conduct credit risk management in respect of our treasury operations primarily through managing credit lines for counterparties. We assign the total credit limit for domestic and foreign financial institutions and set sub-limits for various business lines. Our head office reviews our annual credit limits on exposure to financial institutions, determines authorization limits for our various departments at our head office and domestic and overseas branches, and engages in dynamic risk classification and adjustment in response to changes in counterparty risk.

Internal Rating Based System (IRBS) for Credit Risks

We launched an internal rating-based system in 2007 in order to improve our ability to measure credit risks and to comply with Basel II and the regulatory requirements of the CBRC. We developed our internal rating framework in three stages, with the adoption of a non-retail Foundation Internal Ratings-Based (FIRB) approach being the first stage, the adoption of a retail Advanced Internal Ratings-Based (AIRB) approach being the second stage and the adoption of a non-retail AIRB approach being the third stage. To date, we have completed Phase I (non-retail FIRB approach) and are still in Phase II (retail AIRB approach) of our internal rating project.

Information Technology in Credit Risk Management

The CMS is our primary IT platform for credit business operations as well as the primary tool for credit risk management. For details of our CMS, see "Business—Information Technology—Information System."

Our CMS enables us to integrate the management of our corporate and retail customers. It covers loans, discounted bills, acceptances, letters of credit, letters of guarantee and other main credit products we offer. It also supports online management of our entire credit management process from loan application, review and approval to disbursement and post-disbursement management. It has the capability to conduct customer credit ratings automatically based on quantitative indicators and credit risk classification and determine market risk-related asset value markdowns. Our CMS allows speedy data retrieval and customized reporting. We are in the process of upgrading our CMS, which is expected to improve our credit risk management capability through a more automated system.

Moreover, to support the development of a new customer rating model, we have completed the development of IRBS. The IRBS has been in operation since June 2009.

In the second half of 2009, we launched a project to develop a credit risk data warehouse supported by a credit risk-weighted asset calculation engine. We believe that the completion of this project will enable us to improve our capabilities in collecting and processing data for credit risk-weighted asset calculation and generating reports for regulatory compliance and internal control purposes.

MARKET RISK MANAGEMENT

Market risk arises from movements in exchange rates, interest rates and other market changes that affect market risk-sensitive instruments.

We are exposed to market risk primarily through the assets and liabilities on our balance sheet, as well as our off-balance sheet commitments and guarantees. The major types of market risk that may impact our business are interest rate risk and exchange rate risk. Interest rate risk refers to the risk of losses in a bank's income or economic value arising from adverse movements in statutory or market interest rates. Exchange rate risk means that a bank may experience losses because of mismatches in the currency denomination of our assets and liabilities, or from the exposure of our foreign exchange derivative transactions.

Our market risk management covers the entire process of identifying, measuring, monitoring and controlling market risk and aims to maximize our returns within the limit of our well-defined risk tolerance. We primarily conduct market risk management through exposure limit management, authorization management and counter-party credit extension management. Exposure limit management refers to the control over the level of market risk that our head office, branches and overseas operations are facing. The Risk Management Department at our head office sets exposure limit authorizations in respect of our various business departments which are subject to the approval of the Board of Directors. There are two types of limits, namely, mandatory limits and recommended limits. A mandatory limit places a strict ceiling on the amount of market risk we are willing to accept on the relevant business or products; by contrast, a recommended limit provides a relatively flexible constraint on the market risk and is geared more toward providing risk guidance and warning. In the case of a breach of a recommended limit, we take measures to reduce our risk exposure. In the case of a breach of a mandatory limit, the business unit bearing the market risk is required to take remedial measures unless there are justifiable reasons or circumstances that warrant the exposure temporarily exceeding the limit. The organizational unit is required to specify the reasons for such breaches and the time needed for resolving the situation in a report to be reviewed by the Risk Management Department at our head office, which in turn will report the situation to our senior management. Absent approval by our head office senior management, the unit that breached the mandatory limit must take appropriate measures to ensure that the limit is restored. Market risk limits include, but are not limited to, exposure, loss, risk and stress testing limits. Exposure limits include limits on positions for transactions in total or for net transactions, and limits related to our business targets. Loss limits refer to limits on loss in the mark-to-market value of asset portfolios. Risk limits refer to the limits set for indicators for measuring market risk. Stress testing limits refer to limits for losses that occurred in a stress scenario.

We closely monitor market risk exposure limits through both the Risk Management Department and the risk management divisions of the Asset and Liability Management Department and the Financial Market Department. For a mandatory limit, an early warning is activated once a threshold of 80% of the limit is reached; for a recommended limit, the threshold is 90%. Our trading management system allows us to monitor and analyze data for the entire transaction process. Market risk reports consist of market risk analysis reports, market risk event reports and market risk management reports. We plan to continue to institutionalize and standardize our market risk monitoring and reporting policies and procedures to further improve our ability to monitor and mitigate market risk.

We separate our banking book and trading book. Our trading book covers the financial instruments and commodities positions we hold for trading or hedging purposes. Our banking book covers all of our on- and off-balance sheet assets and liabilities and off-balance sheet positions not covered in the trading book.

Market Risk Management for Our Banking Book

Interest Rate Risk Management

The major source of interest rate risk in our banking book is the mismatch of the maturity or repricing dates of our interest rate-sensitive assets and liabilities. Due to the mismatch, our net interest income and economic value may be affected by changes in interest rates. We currently manage the interest rate risk in our banking book primarily through managing our assets and liabilities mix. The general strategy of interest rate risk management is to identify interest rate risk, adjust assets and liabilities pricing in a timely manner and control interest rate sensitivity exposure. Applying interest rate sensitivity and gap analysis, we conduct static measurements of the repricing characteristics of our assets and liabilities and evaluate the potential impact of changes in interest rates. Based on the results of such analysis, we adjust the maturity structure of our assets and liabilities and improve the management of the interest rate risk exposure in our banking book.

Exchange Rate Risk Management

Exchange rate risk refers to the risk due to mismatches in the currency denominations of our assets and liabilities. Through exposure limit management and the management of the currency structure of our assets and liabilities, we seek to ensure that the adverse impact of exchange rate fluctuations falls within an acceptable range.

Market Risk Management for Our Trading Book

Market risk arising from our trading book primarily comes from fluctuations in the value of our financial instruments on the trading book resulting from changes in exchange rates and interest rates. We utilize interest risk sensitivity indicators such as duration and basis point value and apply analytical tools to monitor the market risks of our trading accounts and improve the interest rate risk management of the financial instruments in our trading book. In addition, we strictly segregate the trading from non-trading functions and responsibilities, monitor and ensure the compliance of our trading positions with our policies. Moreover, our Audit Office conducts regular audits on the implementation of our internal procedures for the management of our trading book in accordance with requirements by our regulators and our own policies.

LIQUIDITY RISK MANAGEMENT

Liquidity risk refers to the risk of being unable to liquidate a position in a timely manner to acquire sufficient funds or failing to acquire sufficient funds at a reasonable cost to fulfill payment obligations. Factors affecting our liquidity include the term structure of our assets and liabilities and changes to banking industry policies, such as changes in the requirements relating to loan-to-deposit ratio and statutory deposit reserve ratio. We are exposed to liquidity risk primarily in the funding of our lending, trading and investment activities, as well as in the management of our liquidity positions. The primary objective of our liquidity risk management is to ensure that we are able to meet our payment obligations and fund our lending and investment operations on a timely basis. We seek to improve our liquidity management through various measures, including:

- focusing on maintaining stable sources of funding and increasing our core deposits;
- enhancing our marketing efforts, increasing our total deposit amount, securing the continued growth in deposits to meet our liquidity needs and maintaining our capital raising capabilities; and
- improving the diversity of assets and maintaining an appropriate mix of short-, medium- or long-term assets.

OPERATIONAL RISK MANAGEMENT

Operational risk refers to the risk resulting from inadequate or failed internal control procedures, from human or information system related factors, or from external events. The operational risk that we face primarily includes, among others, internal fraud, external fraud, damages to property, disruptions to our operations or information technology system and problems associated with transaction execution and closing as well as business processes. Since 2009, we have implemented initiatives to streamline our business and operational processes and centralize our back office management to enhance our capabilities in the identification, measurement, reporting and control of operational risks. We believe that these measures will strengthen our operational risk management.

We have established three lines of defense against operational risk. The first line is risk management by business units. The second line is our risk management departments and internal control and compliance departments. Led by our senior management, our risk management departments are responsible for implementing operational risk management strategies, policies and procedures; developing and promoting operational risk management instruments; monitoring and reporting operational risks; and deploying economic capital measurement tools. Our internal control and compliance departments supervise and evaluate compliance with our operational risk management policies and applicable laws and regulations. The third line is our internal audit function, which is responsible for supervising and evaluating our operational risk management system, evaluating the adequacy and effectiveness of our operational risk management policies and procedures and supervising and assessing our internal control system and compliance.

Since 2008, we have conducted a comprehensive review of 25 areas of our business including our credit business, retail banking, operations management, e-banking and information technology. Through such review, we have identified risk factors and risk indicators, developed operational risk identification procedures, and established procedures for monitoring and assessing key risk areas as well as a dynamic mechanism for continuous risk identification.

We identify operational risk through the process analysis methodology, which identifies the business areas that may be subject to operational risk, and locate potential risk factors and the relevant risk indicators based on our past experience. Our head office and our tier-1 branches carry out, at least once a year, a comprehensive operational risk identification process and systematically review risk factors and risk indicators that have emerged in our operations.

We have established a bottom-up reporting system for operational risk. Once an operational risk occurs, our branches at or above the county level are required to report the operational risk in a timely manner through our operational risk reporting lines.

COMPLIANCE

Compliance risk refers to the risk of regulatory or legal breaches that may result in potential legal sanctions, regulatory penalties, significant financial losses and reputational harm. Compliance management is an important part of our risk management activities. To strengthen our compliance management capabilities, we have established, and are committed to continuing to strengthen, our bank-wide compliance management framework.

Organizational Structure of Our Compliance Function

Our Internal Control and Compliance Department leads our compliance risk management efforts. It is responsible for our bank-wide compliance risk management, including identifying compliance risks, tracking and analyzing control weaknesses and deficiencies, monitoring and assessing our risk exposures and implementing preventative and corrective measures. We have internal control and compliance management teams at our tier-1 and tier-2 branches and have launched a pilot program to appoint compliance managers to selected sub-branches. The compliance managers under the pilot program do not report to the sub-branches where they work; instead, they are under the direct supervision of the higher-tier branches that appointed them and report directly to the management of their respective higher-tier branches.

We seek to improve our compliance reporting mechanism and our database for non-compliance incidents. We have established internal reporting procedures for employee misconduct. Significant cases of employee misconduct are required to be escalated through the higher-tier branches to our head office within 24 hours of the discovery of these cases. In addition, we are also required to report to the CBRC significant cases of employee misconduct. To promote compliance awareness of our employees, we have adopted a points program to deter incidents of non-compliance. In addition, we have started to compile a comprehensive compliance handbook to describe and refine our business and operational process.

Anti-money Laundering

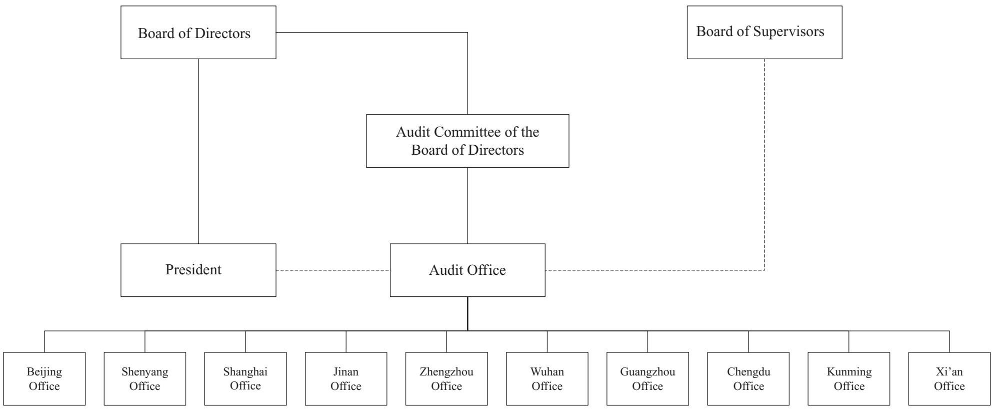
In 2002, we established a steering group responsible for anti-money laundering management. In 2003, we formed an anti-money laundering division at our head office. Currently, the Internal Control and Compliance Department leads our bank-wide anti-money laundering efforts.

We have developed and refined anti-money laundering policies, clearly defining the duties and responsibilities, working procedures, and authorizations of our various departments and branches. We invest heavily in our anti-money laundering compliance efforts and provide regular training to our employees to strengthen their compliance awareness and skills. We are committed to fulfilling our reporting obligations under anti-money-laundering laws and have been cooperating with regulatory authorities and the judiciaries to carry out anti-money laundering investigations. We systematically carry out customer due diligence, collect customer information and transaction records according to applicable laws and regulations. We seek to continue to improve our anti-money laundering capabilities and our compliance with bank-wide anti-money laundering policies and procedures through reinforcing the implementation of the "know-your-customer" procedures and standardized operational processes, improving our information collection and processing capabilities relating to large and suspicious transactions and strengthening our review and reporting of these transactions, as well as enhancing the functionality of our anti-money laundering information system to generate risk alerts on a timely basis.

INTERNAL AUDIT

We have established a designated internal audit function, which follows a vertical reporting line. Our internal audit offices perform audits and evaluations on our operations and management, business activities and financial performance. Our internal audit offices report to our Board of Directors and are subject to the examination, supervision and evaluation by the Audit Committee of our Board of Directors. Our internal audit offices are also under the supervision of our Board of Supervisors. Our internal audit offices consist of the Audit Office at our head office and ten regional offices. The Audit Office is responsible for the organization, management and reporting of our bank-wide internal audit efforts. The regional offices, under the direct supervision of the Audit Office, perform internal audits in their respective specified areas and report to the Audit Office.

The chart below shows the organizational structure of our internal audit function:



Our internal audits are organized in an effort to promote our compliance with and implementation of the applicable laws and regulations, assess our risk management, internal control and corporate governance and maintain our risk exposures within an acceptable range to continue to improve our business operations and management.

Our internal audit focuses on:

- our compliance with the applicable PRC laws and regulations, macroeconomic policies and regulatory guidelines as well as our internal policies and procedures;
- the soundness and effectiveness of compliance in our operations, the performance of our compliance departments and the effectiveness and efficiency of our various departments;
- the integrity, soundness and effectiveness of our internal control system;
- our risk exposures and the applicability and effectiveness of our risk identification, measurement and monitoring procedures;
- the accuracy and reliability of our accounting records and financial statements;
- the management, use and disposal of our various assets;

- the results of our operations and the implementation of our business plans and financial budgets;
- the planning, development, operation and maintenance of our information system;
- performance audits and departure audits of the executive officers of our head office (including various divisions of our head office), tier-1 branches and branches directly managed by our head office and the nominees for such executive officers;
- the remediation measures in respect of the issues identified in our internal audits; and
- other internal audits requested by the Board of Directors and the Audit Committee under the Board of Directors.

According to the internal audit guidelines applicable to the PRC banking institutions promulgated by the CBRC, internal audit staff are required to constitute no less than 1% of the employees. The number of the staff of our Audit Office and its ten regional offices is not in compliance with such regulatory requirement, nonetheless the total number of our employees, our staff members performing the internal audit function, including internal control and compliance staff who participate in performance audits, compliance review and internal control evaluation, constitute more than 1% of all of our employees.